

**BUSINESS, TRANSPORTATION AND HOUSING AGENCY
CALIFORNIA FILM COMMISSION**

NOTICE OF PROPOSED RULEMAKING

December 16, 2011

Notice is hereby given that the California Film Commission (“CFC”) proposes to adopt the regulatory changes described below after considering all comments, objections and recommendations regarding the proposed action.

1. Title 10. Investment, Chapter 7.75. California Film & Television Tax Credit Program
Section 5501, Application Process For Tax Credit Allocation
Section 5506, Credit Certification Issuance Process

PUBLIC HEARING

A public hearing on this proposed action has not been scheduled. However, the CFC will hold a hearing if it receives a written request for a public hearing from any interested person, or his or her authorized representative, no later than 15 days before the close of the written comment period.

WRITTEN COMMENT PERIOD

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory actions to the CFC. Written comments will be accepted by the CFC until 5:00 p.m. on January 30, 2012. Submit comments to:

Amanda Esquivias
Business, Transportation and Housing Agency
980 Ninth Street, Suite 2450
Sacramento, CA 95814
Amanda.Esquivias@bth.ca.gov

AUTHORITY AND REFERENCE

The proposed regulation has been adopted under the authority of Government Code section 11152, and Revenue and Taxation Code sections 17053.85(e) and 23685(e) and in order to implement, interpret, and make specific Revenue and Taxation Code sections 17053.85 and 23685.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

The CFC proposes to amend sections 5501 and 5506 of Title 10 of the CCR. Revenue and Taxation Code sections 17053.85 and 23685 provide for a California tax credit for qualified

expenditures in the production of a qualified motion picture in California for taxable years beginning on or after January 1, 2011. The CFC implemented the California Film and Television Tax Credit program in June 2010. The program specifically targets productions that are most likely to leave the state to take advantage of incentives being offered in other state and countries.

The purpose of the amendment is to implement additional reporting requirements of the Revenue and Taxation Code by recent legislative amendments. The regulations proposed in this rulemaking action would implement, interpret and make specific newly added provisions in Revenue and Taxation Code sections 17053.85 and 23685 relating to the CFC's responsibility to establish procedures for applicants to file a written application for the allocation of the tax credit, establish criteria for allocating tax credits, determine and designate applicants who meet the requirements to apply for the tax credit, and issue the credit certificate to the qualified taxpayer upon completion of the qualified motion picture.

This regulation will also amend the corresponding CFC forms, incorporated by reference, that are required to be submitted during the application and filming process.

Section 5501. Application Process for Tax Credit Allocation

Section 5501 provides for an application process for the tax credit program.

Subsection (c) incorporates by reference the California Film & Television Tax Credit Program Application Form, CFC Form A, dated November 18, 2011. The application form has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code. Submission of an electronic copy is added. Statute mandates the Commission to share application materials with Legislative Analyst's Office (LAO), preferably in an electronic format.

Subsection (c)(4) provides that an incomplete application shall not be eligible for tax credit allocation. The amount of days required of applicants to submit missing information is changed from three (3) to five (5) as 3 days has been found to be insufficient. This section has been amended to state that failure to supply information within this time frame may be cause to remove the applicant from the queue, but not a mandate.

Subsection (d) describes all the documents to be submitted with a complete application to be eligible for a tax credit. "Initial" has been added to indicate a two-step application process. This provision is for clarity. When an applicant submits an application, it is not necessary for the applicant to submit corporate financial information until credits become available.

Subsection (e) indicates that when it is determined that credits are available, applicants will submit further financial documentation requested. This information is to be submitted in electronic format via a secure email address to the tax credit program in order to electronically transmit to the LAO.

Subsection (e)(1) specifies the submission of a detailed Narrative Statement as defined in the Revenue and Taxation Code. The language has been re-written for clarity and brevity.

Subsection (e)(2) specifies the obligation of partnerships and single member LLCs to provide financial information (subparagraph (A)) and partnership information (subparagraph (B)) as per the Revenue and Taxation Code. It also states that this information is not subject to public disclosure.

Subsection (e)(3) specifies that subsections (A) and (B) pertain to applicants that are publicly traded companies.

Subsection (e)(3)(A) indicates that applicants are to list all members of a combined reporting group and any members to whom they anticipate assigning the credit as per the Revenue and Taxation Code. The statute asks for the names of members to whom the credit is assigned, but the credit is not assigned until the Qualified Taxpayer has received a tax credit certificate and filed with the Franchise Tax Board. This section clarifies to ask for the names of the members of a combined reporting group or members to whom they anticipate assigning the credit in the future.

Subsection (e)(3)(B) is added per the Revenue and Taxation Code. The subsection defines the time period for which the applicant is asked to report all states, provinces, or other jurisdictions where they have financed motion pictures. The time period for reporting this information is not specified in the statute. Adding a calendar year reporting time frame will give consistency to the information collected from all applicants.

Due to insertion of a new subsection (e), prior subsections (e), (f), (g), and (h) will be renumbered as subsections (f), (g), (h) and (i).

Section 5506. Credit Certificate Issuance Process

Section 5506 provides for the issuance of the Credit Certificate, which is the document issued to the qualified taxpayer upon completion of the Qualified Motion Picture. This is the official document that the taxpayer will need to submit to the State Franchise Tax Board when filing for the tax credit.

Subsection (a)(4) incorporates by reference the Expenditure Summary Report, CFC Form F, dated November 18, 2011. The form has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code. Requirement for submission of an electronic copy is added in order to electronically transmit to the LAO.

Subsection (a)(5) incorporates by reference the Agreed Upon Procedures Report, dated November 18, 2011. Requirement for submission of an electronic copy is added.

Subsection (a)(11) specifies the submission of revised and/or updated information, as applicable, as requested in Section 5501(e) as part of the verification process for a tax credit certificate. Applicants submit this documentation in an electronic format e-mailed to a tax credit program secure e-mail address.

California Film and Television Tax Credit Program Application Form, CFC Form A

The Application Form is the initial document required to apply for tax credits. The statute specifies that the CFC shall establish a procedure for applicants to file a written application with the Commission. The application form has been jointly prescribed by the CFC and the Franchise Tax Board, as required by statute. The FTB has submitted written approval of the Application Form.

The application form has been amended as follows:

Section 7 provides a required materials checklist for submittal with the application. Initial Application Materials remains unchanged. The materials Upon Request has been added to describe the documents required in the amended regulations, Section 5501. Application Process for Tax Credit Allocation, subsection (e).

Expenditure Summary Report, CFC Form F

This form is used to gather final expenditure information and statistics upon completion of a Qualified Motion Picture. The information on this form is used to determine the economic impact on the state, including employees hired and wages in both production and post-production. The CFC is required by statute to submit economic impact reports to the Legislature.

The application form has been amended as follows:

Section 6: Materials Checklist has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code indicated in the amended regulations, Section 5506. Credit Certificate Issuance Process.

Agreed Upon Procedures (AUP)

The AUP is a technical tool for the Certified Public Accountant (CPA) to determine what is required and expected in the Agreed Upon Procedures Report and is required to be submitted by the Qualified Taxpayer in order to be issued a Tax Credit Certificate. The AUP has been amended for clarity and to be consistent with the changes to form requirements in these regulations.

The AUP General Section was amended to be consistent with Section 5506, subsection (B) by stating in order to perform AUP for the Tax Credit Program, a CPA must attend an Orientation meeting arranged by the CFC for CPAs.

Section IV, Agreed Upon Procedures Eligibility.

Subsection 5 is amended to delete “during the qualified production period.” The qualified production period does not begin until issuance of the Credit Allocation Letter (CAL); however, some productions may have been on a waitlist and received a CAL after beginning principal photography. The CPA must verify that a production spent either 75% of the budget or filmed 75% of principal photography in the state. Therefore, it is necessary to inspect call sheets, production reports, and other pertinent documentation for all principal photography days, including those which were incurred prior to the CAL. The deletion of “Qualified Production Period” will enable CPAs to inspect all such documentation.

Subsection 6(c) is amended for clarity. CPAs must inspect documentation to verify that the expenditure is qualified. “Cancelled checks” has been replaced with types of documentation more commonly utilized for film productions such as bank statements, check images, credit card statement and reimbursement checks.

Expenditures (other than payroll).

Subsection 2(a) is amended for clarity. CPAs must inspect documentation to verify that the expenditure is qualified. “Cancelled checks” has been replaced with types of documentation more commonly utilized for film productions such as bank statements, check images, credit card statement and reimbursement checks.

Subsection 2(e) is amended to omit reference to insurance claims. Expenditures pertaining to insurance claims and completion bonds may not fall in the selected sample. A separate procedure (6) has been added.

Subsection 2(g) is amended to add a completion bond to the expenditures that can be prorated if paid prior to the issuance of the Credit Allocation Letter. Evidence of proration for insurance premiums and/or completion bond must be provided by the insurance broker or bond company representative, as proration is subject to an industry formula. This section is amended to clarify the determination as to whether an expenditure is qualified is based on when the expenditure was incurred.

Subsection 2(h) is amended to clarify that the determination as to whether an expenditure is qualified is based on when the expenditure was incurred.

Subsection 2(j) is deleted from the AUP for clarity. It can be misinterpreted that the insurance deductible on a claim cannot be considered qualified expenditure. CPAs do not need to test for insurance deductibles. If a production spends its insurance deductible on qualified spend, it will be tested as part of other procedures and verified.

Section 5 is amended for clarity. The listing from the production company does not need to contain names of visual effects, digital effects, post production sound or title companies whose work is not being claimed as qualified expenditure. A definition of the requested documentation is provided for clarity. This documentation must be submitted with the Report.

New Section 6 is added to require the CPA to verify that the qualified expenditures were reduced for any insurance claim reimbursements. Previously, productions did not have to record insurance claim as a credit against costs. Productions are now required to credit insurance claims against production costs, just like any other cost which is reimbursed by a vendor. This amendment will require the applicant to include a letter regarding disclosure of all insurance claim reimbursements, as they could have been misclassified as non-qualified and therefore not included in any sample testing.

With addition of a new section (6), prior sections (6) and (7) became sections (7) and (8).

Subsection (c) of new section 8 is editorially amended to make a correction of procedure numbering due to addition of a procedure. It also makes an amendment for clarity by the addition of “expenditure.”

Payroll.

Section 1 is amended to provide a more concise definition of the requested documentation with examples. This section specifies that the documentation is required to be submitted with the Report and clarifies that submission can be paper or electronic.

Subsections 2(g) and (h) are amended to clarify that the determination as to whether a wage is qualified is based on when the wage expense was incurred.

Section 4 is amended to specify that the CPA will contact the CFC when the CPA is unclear if the wages paid to a producer are within industry standards.

Section 5 is amended to require the CPA to verify that the qualified expenditures were reduced for any insurance claim reimbursements. Previously, productions did not have to record insurance claim as a credit against costs. Productions are now required to credit insurance claims against production costs, just like any other cost which is reimbursed by a vendor. This amendment will require the applicant to include a letter regarding disclosure of all insurance claim reimbursements, as they could have been misclassified as non-qualified and therefore not included in any sample testing. This information may be incorporated into the letter requested in Expenditures (other than payroll) procedure 6.

Non Qualified Testing for Independent Motion Picture.

This section is amended to add the words “if applicable.” The procedure is performed only in specific circumstances according to AUP Eligibility, Procedure 8. This amendment is for clarity.

Related Parties and Other Affiliations.

Section 2 is amended to specify the CPA is required to include a signed letter from the production company representative regarding the full disclosure of Related Party transactions for CFC review.

Section 3 is amended to clarify that the CPA does not need to retest expenditures if related party issues were addressed during previous testing.

Subsection 3(a) is editorially amended for clarity. The procedure concerning related party wages has been moved to (b)(2) to conform to the previous sequence of testing expenditures first and then payroll.

Subsection 3(a)(2) specifies that the CPA must verify the expenditure is qualified as per the procedures listed in Expenditures (other than payroll) section (2), (a-i).

Subsection 3(b)(1) is amended to clarify to the CPA the tax code provisions that must be considered when assessing wages paid to Related Parties. The specific section of the statute is added.

Subsection 3(b)(2) specifies that the CPAs must verify that the wage is qualified as per the procedures listed in the Payroll section (2), (b-h).

Wrap Up Procedures.

Section 2 is amended to add language clarifying the circumstance the CPA is to perform this procedure. The section is also amended to clarify the procedural section.

Section 3 is editorially amended for clarity.

Section 4 is repealed for clarity. This information is included in Wrap Up Procedures (3).

Section 5 is amended to add language clarifying threshold reporting is based on any recent adjustments to production budget and qualified expenditure budgets based on findings from testing.

Appendix A is amended in Payroll Stratum 1 to have the criteria for testing changed from “Employees with total qualified wages under \$100,000” to “Employees with total qualified wages under top 10.” The amendment is to conform to the top stratum testing in this category. This amendment is for clarity and consistency.

Appendix B is amended in Payroll Stratum 1 to have the criteria for testing changed from “Employees with total qualified wages under \$100,000” to “Employees with total qualified wages under top 10.” The amendment is to conform to the top stratum testing in this category. This amendment is for clarity and consistency.

Appendix C is amended to incorporate all the changes in the AUP. This form is used for reporting all findings by the CPA performing the Agreed Upon Procedures.

COST ESTIMATES OF PROPOSED ACTION

The CFC has made the following determinations:

- Mandate on local agencies and school districts: None.
- Cost or savings to the state agency: None.
- Cost to any local agency or school district which must be reimbursed in accordance with Government Code sections 17500 through 17630: None.
- Other nondiscretionary cost or savings imposed on local agencies: None.
- Cost or savings in federal funding to the state: None.
- Significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states: None. The CFC has made this determination based on the fact that the added requirements for providing additional information in a tax credit application and following justification procedures on qualified spending do not affect any businesses other than

the ones that are applying for the tax credit. The same new requirements do not have any effect on competitiveness of a business.

- Potential cost impact on representative person or businesses: The CFC has determined that the proposed regulations would have a minimal economic impact on motion picture production companies. Independent companies may incur an expense in order to provide financial statements. Publicly traded companies would not be impacted financially, as the work can be done by employees. While the newly added requirements in statute and regulation for an expanded application might have an effect on applicants in terms of preparation of the tax credit applications, these are not considered to be significant. These regulations will provide for an increase in revenues and employment in California by bringing more filming business into California.
- Significant effect on housing costs: None.

EFFECT ON SMALL BUSINESS

The CFC has not identified any alternatives that would lessen the adverse impact on small business. The CFC drafted the regulations with the intent of simplifying and clarifying the new requirements as mandated by statute.

ASSESSMENT REGARDING EFFECT ON JOBS/BUSINESS

Adoption of these regulations will (1) facilitate the creation of jobs within California; (2) will facilitate the creation of businesses within California; (3) will facilitate the expansion of businesses currently doing business within California. The CFC has made these determinations based on the facts that the film tax credit will attract production companies to film in California and thereby create additional business or business expansion in film production and associated business providing services to production companies.

REASONABLE ALTERNATIVES CONSIDERED

The CFC must determine that no reasonable alternative considered by the agency or that has otherwise been identified and brought to the attention of the CFC would be more effective in carrying out the purpose for which the action is proposed or would be as effective as and less burdensome to affected private persons than the proposed action.

AGENCY CONTACT INFORMATION

Inquiries concerning the proposed action may be directed to:

Name: Amanda Esquivias
Email: Amanda.Esquivias@bth.ca.gov
Phone: 916-323-5400

The backup contact person for these inquiries is:

Name: Gabor Morocz
Email: Gabor.Morocz@bth.ca.gov
Phone: 916-324-7505

Questions on the substance of the proposed regulations may be directed to:

Name: Amanda Esquivias
Email: Amanda.Esquivias@bth.ca.gov

AVAILABILITY OF CHANGED OR MODIFIED TEXT

After the close of the forty-five (45) day public comment period, the CFC may adopt the proposed regulation. As a result of public comments, either oral or written, that are received by the CFC regarding this proposal, the CFC may determine that changes to the proposed regulation are appropriate. If the CFC makes modifications that are sufficiently related to the originally proposed text, it will make the modified text (with the changes clearly indicated) available to the public for at least 15 days before the CFC adopts the regulations as revised. The CFC will provide notification of any such modifications to all persons whose comments were received during the public comment period, all persons whose comments (written or oral) were received at the public hearing (if one is held), and all persons who requested notice of such modifications. Otherwise, please send requests for copies of any modified regulations to the attention of Amanda Esquivias at the above email address. The CFC will accept written comments on the modified regulations for 15 days after the date on which they are made available.

AVAILABILITY OF INITIAL STATEMENT OF REASONS, RULEMAKING FILE AND EXPRESS TERMS OF THE PROPOSED REGULATIONS

The CFC has established a rulemaking file for this regulatory action, which contains those items required by law. The file is available for inspection at the Business, Transportation and Housing Agency, 980 Ninth Street, Suite 2450, California during normal business working hours (9 am- 5 pm). Please contact Amanda Esquivias at the above email address to arrange a date and time to inspect the files. As of the date this Notice is published in the Notice Register, the rulemaking file consists of this Notice, the Initial Statement of Reasons and the proposed text of the regulations. Copies of these items are available, upon request, from the CFC Contact Person designated in this Notice.

AVAILABILITY OF FINAL STATEMENT OF REASONS

The CFC is required to prepare a Final Statement of Reasons. Once the CFC has prepared a Final Statement of Reasons, a copy will be made available to anyone who requests a copy. Requests for copies should be addressed to the CFC Contact Person identified in this Notice.

CFC INTERNET WEBSITE

The CFC maintains an Internet website for the electronic publication and distribution of written material. Copies of the Notice of Proposed Action, the Initial Statement of Reasons, and the text of the regulations in underline and strikeout can be accessed through the CFC website on the Internet at: www.film.ca.gov.

BUSINESS, TRANSPORTATION AND HOUSING AGENCY

California Film and Television Tax Credit Program

Title 10, Chapter 7.75, Sections 5501, 5506

INITIAL STATEMENT OF REASONS

SPECIFIC PURPOSE OF THE REGULATION

The proposed regulation will modify the procedures for allocating tax credits to qualified taxpayers in the motion picture industry.

NECESSITY

Revenue and Taxation Code sections 17053.85 and 23685 provide for a California tax credit for qualified expenditures in the production of a Qualified Motion Picture in California for taxable years beginning on or after January 1, 2011.

Revenue and Taxation Code sections 17053.85 and 23685 provide that the California Film Commission (CFC) establish a procedure for applicants to file a written application for the allocation of the tax credit, establish criteria for allocating tax credits, determine and designate applicants who meet the requirements to apply for the tax credit, and issue the credit certificate to the qualified taxpayer upon completion of the Qualified Motion Picture.

The purpose of the amendment is to implement additional reporting requirements of the Revenue and Taxation Code. This regulation will also amend the corresponding CFC forms, incorporated by reference, that are required to be submitted during the application and filming process.

PROPOSED REGULATORY ACTION

Section 5501. Application Process for Tax Credit Allocation

Section 5501 provides for an application process for the tax credit program.

Subsection (c) incorporates by reference the California Film & Television Tax Credit Program Application Form, CFC Form A, dated November 18, 2011. The application form has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code. Submission of an electronic copy is added. Statute mandates the Commission to share application materials with Legislative Analyst's Office (LAO), preferably in an electronic format.

Subsection (c)(4) provides that an incomplete application shall not be eligible for tax credit allocation. The amount of days required of applicants to submit missing information is changed from three (3) to five (5) as 3 days has been found to be insufficient. This section has been amended to state that failure to supply information within this time frame may be cause to remove the applicant from the queue, but not a mandate.

Subsection (d) describes all the documents to be submitted with a complete application to be eligible for a tax credit. "Initial" has been added to indicate a two-step application process. This provision is for

clarity. When an applicant submits an application, it is not necessary for the applicant to submit corporate financial information until credits become available.

Subsection (e) indicates that when it is determined that credits are available applicants will submit further financial documentation requested. This information is to be submitted in electronic format via a secure email address to the tax credit program in order to electronically transmit to the LAO, if requested.

Subsection (e)(1) specifies the submission of a detailed Narrative Statement as defined in the Revenue and Taxation Code. The language has been re-written for clarity and brevity.

Subsection (e)(2) specifies the obligation of partnerships and single member LLCs to provide financial information (subparagraph (A)) and partnership information (subparagraph (B)) as per the Revenue and Taxation Code. It also states that this information is not subject to public disclosure.

Subsection (e)(3) specifies that subsections (A) and (B) pertain to applicants that are publicly traded companies.

Subsection (e)(3)(A) indicates that applicants are to list all members of a combined reporting group and any members to whom they anticipate assigning the credit as per the Revenue and Taxation Code. The statute asks for the names of members to whom the credit is assigned, but the credit is not assigned until the Qualified Taxpayer has received a tax credit certificate and filed with the Franchise Tax Board. This section clarifies to ask for the names of the members of a combined reporting group or members to whom they anticipate assigning the credit in the future.

Subsection (e)(3)(B) is added per the Revenue and Taxation Code. The subsection defines the time period for which the applicant is asked to report all states, provinces, or other jurisdictions where they have financed motion pictures. The time period for reporting this information is not specified in the statute. Adding a calendar year reporting time frame will give consistency to the information collected from all applicants.

Due to insertion of a new subsection (e), prior subsections (e), (f), (g), and (h) will be renumbered as subsections (f), (g), (h) and (i).

Section 5506. Credit Certificate Issuance Process

Section 5506 provides for the issuance of the Credit Certificate, which is the document issued to the qualified taxpayer upon completion of the Qualified Motion Picture. This is the official document that the taxpayer will need to submit to the State Franchise Tax Board when filing for the tax credit.

Subsection (a)(4) incorporates by reference the Expenditure Summary Report, CFC Form F, dated November 18, 2011. The form has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code. Requirement for submission of an electronic copy is added in order to electronically transmit to the LAO, upon request.

Subsection (a)(5) incorporates by reference the Agreed Upon Procedures Report, dated November 18, 2011. Requirement for submission of an electronic copy is added.

Subsection (a)(11) specifies the submission of revised and/or updated information, as applicable, as requested in Section 5501(e) as part of the verification process for a tax credit certificate. Applicants submit this documentation in an electronic format emailed to a tax credit program secure e-mail address.

California Film and Television Tax Credit Program Application Form, CFC Form A

The Application Form is the initial document required to apply for tax credits. The statute specifies that the CFC shall establish a procedure for applicants to file a written application with the Commission. The application form has been amended as follows:

Section 7 provides a required materials checklist for submittal with the application. Initial Application Materials remains unchanged. The materials Upon Request has been added to describe the documents required in the amended regulations, Section 5501. Application Process for Tax Credit Allocation, subsection (e).

Expenditure Summary Report, CFC Form F

This form is used to gather final expenditure information and statistics upon completion of a Qualified Motion Picture. The information on this form is used to determine the economic impact on the state, including employees hired and wages in both production and post-production. The Business, Transportation and Housing Agency on behalf of the CFC is required by statute to submit economic impact reports to the Legislature.

The application form has been amended as follows:

Section 6: Materials Checklist has been modified to incorporate the additional reporting requirements in the Revenue and Taxation Code indicated in the amended regulations, Section 5506. Credit Certificate Issuance Process. The checklist clarifies and lists several required documents: the requirement of submitting a certificate of copyright rather than proof that the applicant has filed for copyright; listing of documents that applicant is required to submit as per the Agreed Upon Procedures.

Agreed Upon Procedures (AUP)

The AUP is a technical tool for the Certified Public Accountant (CPA) to determine what is required and expected in the Agreed Upon Procedures Report and is required to be submitted by the Qualified Taxpayer in order to be issued a Tax Credit Certificate. The AUP has been amended for clarity and to be consistent with the changes to form requirements in these regulations.

The AUP General Section was amended to be consistent with Section 5506, subsection (B) by stating in order to perform AUP for the Tax Credit Program, a CPA must attend an Orientation meeting arranged by the CFC for CPAs.

Section IV, Agreed Upon Procedures Eligibility.

Subsection 5 is amended to delete “during the qualified production period.” The qualified production period does not begin until issuance of the Credit Allocation Letter (CAL); however, some productions may have been on a waitlist and received a CAL after beginning principal photography. The CPA must verify that a production spent either 75% of the budget or filmed 75% of principal photography in the state. Therefore, it is necessary to inspect call sheets, production reports, and other pertinent documentation for all principal photography days, including those which were incurred prior to the CAL. The deletion of “Qualified Production Period” will enable CPAs to inspect all such documentation.

Subsection 6(c) is amended for clarity. CPAs must inspect documentation to verify that the expenditure is qualified. “Cancelled checks” has been replaced with types of documentation more commonly utilized for film productions such as bank statements, check images, credit card statement and reimbursement checks.

Expenditures (other than payroll).

Subsection 2(a) is amended for clarity. CPAs must inspect documentation to verify that the expenditure is qualified. "Cancelled checks" has been replaced with types of documentation more commonly utilized for film productions such as bank statements, check images, credit card statement and reimbursement checks.

Subsection 2(e) is amended to include insurance claim reimbursements in the listing of expenditures which must be credited to the cost report. This is per normal accounting practices. The section also omits reference to completion bonds. Expenditures pertaining to completion bonds may not fall in the selected sample. A separate procedure (6) has been added.

Subsection 2(g) is amended to add a completion bond to the expenditures that can be pro-rated if paid prior to the issuance of the Credit Allocation Letter. Evidence of proration for insurance premiums and/or completion bond must be provided by the insurance broker or bond company representative, as proration is subject to an industry formula. This section is amended to clarify the determination as to whether an expenditure is qualified based on when the work was incurred.

Subsection 2(h) is amended to clarify that the determination as to whether an expenditure is qualified based on when the expenditure was incurred.

Subsection 2(j) is deleted from the AUP for clarity. It can be misinterpreted that the insurance deductible on a claim cannot be considered qualified expenditure. CPAs do not need to test for insurance deductibles. If a production spends its insurance deductible on qualified spend, it will be tested as part of other procedures and verified.

Section 5 is amended for clarity. The listing from the production company does not need to contain names of visual effects, digital effects, post production sound or title companies whose work is not being claimed as qualified spend. A definition of the requested documentation is provided for clarity. This documentation must be submitted with the Report.

New section 6 is added to require the CPA to verify that the qualified expenditures were reduced for any insurance claim reimbursements. Previously, productions did not have to record insurance claims as a credit against costs. Productions are now required to credit insurance claims against production costs, just like any other cost which is reimbursed by a vendor. This amendment will require the applicant to include a letter regarding disclosure of all insurance claim reimbursements, as they could have been misclassified as non-qualified and therefore not included in any sample testing. The CPA must also verify that completion bond rebates have been reported in the cost report.

With addition of a new section 6, prior sections 6 and 7 became sections 7 and 8.

Subsection (c) of new section 8 is editorially amended to make a correction of procedure numbering due to addition of a procedure. It also makes an amendment for clarity by the addition of "expenditure."

Payroll.

Section 1 is amended to provide a more concise definition of the requested documentation with examples. This section specifies that the documentation is required to be submitted with the Report and clarifies that submission can be paper or electronic.

Subsections 2(g) and (h) are amended to clarify that the determination as to whether a wage is qualified is based on when the wage expense was incurred.

Section 4 is amended to specify that the CPA will contact the CFC when the CPA is unclear if the wages paid for a qualified position to an individual who also receives a credit for a position which is considered non-qualified for the tax credit are within industry standards.

Section 5 is amended to require the CPA to verify that the qualified payroll expenditures were reduced for any insurance claim reimbursements. Previously, productions did not have to record insurance claim as a credit against costs. Productions are now required to credit insurance claims against production costs, just like any other cost which is reimbursed by a vendor. This amendment will require the applicant to include a letter regarding disclosure of all insurance claim reimbursements, as they could have been misclassified as non-qualified and therefore not included in any sample testing. This information may be incorporated into the letter requested in Expenditures (other than payroll) procedure 6.

Non Qualified Testing for Independent Motion Picture.

This section is amended to add the words "if applicable." The procedure is performed only in specific circumstances according to AUP Eligibility, Procedure 8. This amendment is for clarity.

Related Parties and Other Affiliations.

Section 2 is amended to specify the CPA is required to include a signed letter from the production company representative regarding the full disclosure of Related Party transactions for CFC review.

Section 3 is amended to clarify that the CPA does not need to retest expenditures if related party issues were addressed during previous testing.

Subsection 3(a) is editorially amended for clarity. The procedure concerning related party wages has been moved to (b)(2) to conform to the previous sequence of testing expenditures first and then payroll.

Subsection (a)(2) specifies that the CPA must verify the expenditure is qualified as per the procedures listed in Expenditures (other than payroll) section (2), (a-i).

Subsection (b)(1) is amended to clarify to the CPA the tax code provisions that must be considered when assessing wages paid to Related Parties. The specific section of the statute is added.

Subsection (b)(2) specifies that the CPAs must verify that the wage is qualified as per the procedures listed in the Payroll section (2), (b-h).

Section 4 is amended to clarify that either an electronic or paper copy of all related party transactions must be submitted to the CFC for review.

Wrap Up Procedures.

Section 2 is amended to add language clarifying the circumstance the CPA is to perform this procedure. The section is also amended to clarify the procedural section.

Section 3 is editorially amended for clarity.

Section 4 is repealed for clarity. This information is included in Wrap Up Procedures (3).

New Section 4 is amended to add language clarifying threshold reporting is based on any recent adjustments to production budget and qualified expenditure budgets based on findings from testing.

Appendix A is amended in Payroll Stratum 1 to have the criteria for testing changed from “Employees with total qualified wages under \$100,000” to “Employees with total qualified wages under top 10.” The amendment is to conform to the top stratum testing in this category. This amendment is for clarity and consistency.

Appendix B is amended in Payroll Stratum 1 to have the criteria for testing changed from “Employees with total qualified wages under \$100,000” to “Employees with total qualified wages under top 10.” The amendment is to conform to the top stratum testing in this category. This amendment is for clarity and consistency.

Appendix C is amended to incorporate all the changes in the AUP. This form is used for reporting all findings by the CPA performing the Agreed Upon Procedures.

TECHNICAL, THEORETICAL, AND /OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The CFC did not rely upon any technical, theoretical, or empirical studies, reports, or documents in proposing the adoption of this regulation. The added regulations simply implement new statutory provisions.

REASONABLE ALTERNATIVES TO THE REGULATION AND THE CFC’S REASON FOR REJECTING THOSE ALTERNATIVES

The alternative of not adding new regulations has been considered by the CFC. However, it was determined that implementation of new statutory provisions was absolutely necessary to implement the newly added requirements by statute. This regulation simply implements the newly added provisions to Revenue and Taxation Code sections 17053.85 and 23623.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The CFC has not identified any alternatives that would lessen the adverse impact on small business. The CFC drafted the regulations with the intent of simplifying and clarifying the new requirements as mandated by statute.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The CFC has determined that the proposed regulations would have a minimal economic impact on motion picture production companies. Independent companies may incur an expense in order to provide financial statements. Publicly traded companies would not be impacted financially, as the work can be done by employees. While the newly added requirements in statute and regulation for an expanded application might have an effect on applicants in terms of preparation of the tax credit applications, these are not considered to be significant. These regulations will provide for an increase in revenues and employment in California by bringing more filming business into California.

SPECIFIC TECHNOLOGY OR EQUIPMENT

This proposal will not mandate the use of specific technologies or equipment.